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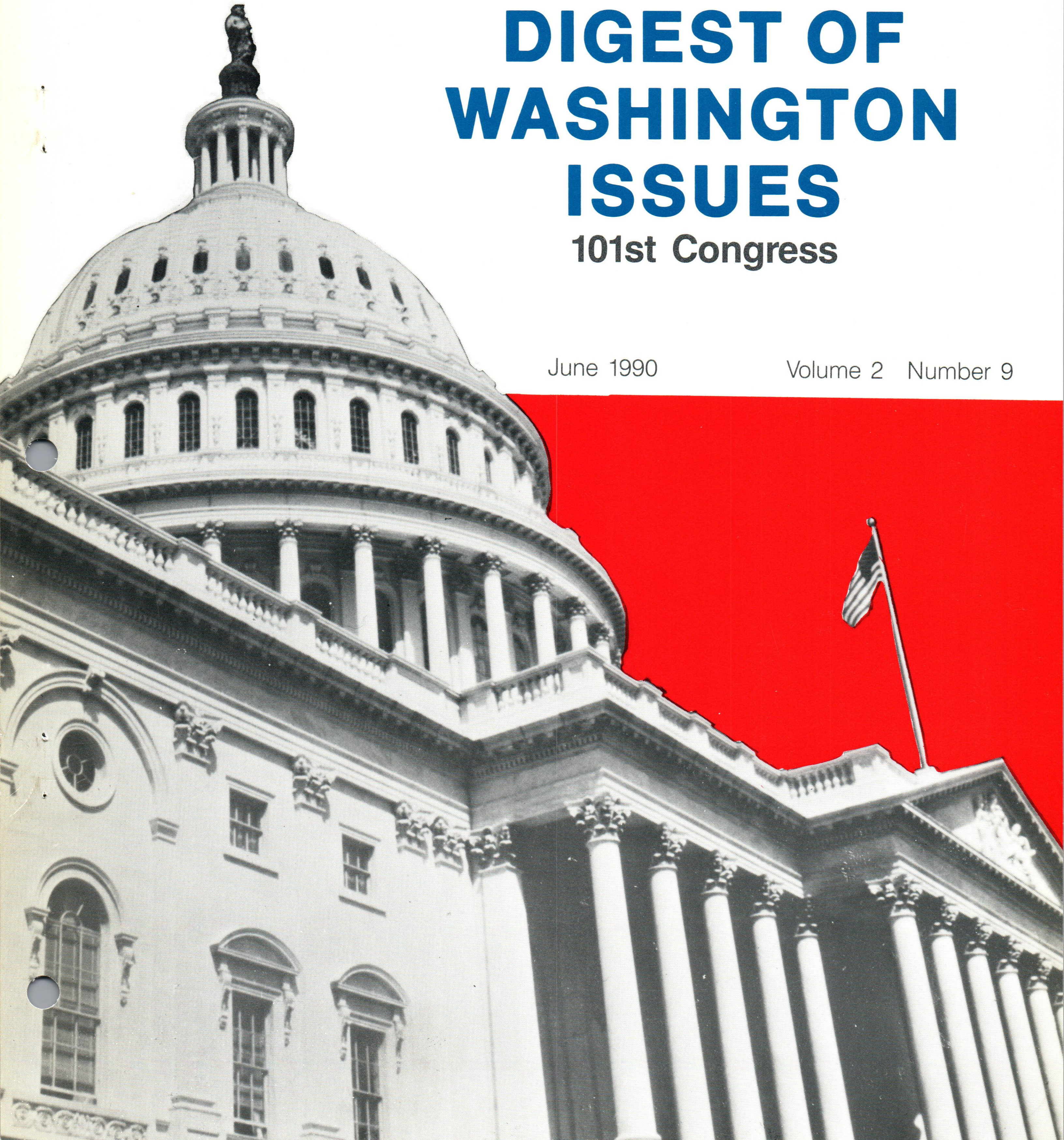

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DIGEST OF WASHINGTON ISSUES

Issues

Tax Issues

(<u>Boldfaced, underlined</u> type in the text of the <u>Digest</u> indicates changes since the last issue. The date in the lower right hand corner of each page indicates the most recent date of revision.)

EXECUTIVE SUMMARY

Racketeer Influenced and Corrupt Organizations Act (RICO)

Amending the civil provisions of the Racketeer Influenced and Corrupt Organizations Act (RICO) of the 1970 Organized Crime Control Act has been a major goal of the AICPA since the 99th Congress. RICO permits private parties to sue for treble damages and attorneys' fees when those individuals have been injured by a "pattern of racketeering activity" in certain relationships to an "enterprise." Because such crimes as mail fraud, wire fraud, and securities fraud are included in the RICO law, many accountants are named as co-defendants in suits arising out of regular business failures, securities offerings, and other investment disappointments. The Senate Judiciary Committee approved S. 438, legislation to reform civil RICO on February 2, 1990. A vote by the full Senate has not yet been scheduled. **A new proposal, H.R. 5111, to reform RICO was also introduced by leaders on the issue in the House on June 21, 1990. This bill will be considered by the House Crime Subcommittee on June 26, 1990**. For further details see page 5.

Congressional Oversight of the SEC's Enforcement and the Accounting Profession's Performance Under the Securities Laws

The Oversight and Investigations Subcommittee of the House Energy and Commerce Committee has conducted 23 hearings since 1985 focusing on the effectiveness of independent accountants who audit publicly owned corporations and the performance of the SEC in meeting its responsibilities. **While no hearings have been held in this Congress, Rep. Ron Wyden (D-OR) has circulated for comment a draft bill which would require auditors to 1) report on internal controls and 2) report on evidence of material financial fraud or potential financial failure to regulators. The AICPA has opposed similar legislation in the past**. The AICPA believes independent auditors are fulfilling their obligations under the federal securities laws and has an on-going effort aimed at improving audits performed by CPAs and addressing changes and developments in the marketplace. For further details see page 6.

DOL OIG Reports on Pension Plan Security and ERISA Audits

The Department of Labor (DOL) Office of Inspector General (OIG) has reviewed independent audits of private pension plans and made several recommendations including 1) Require full-scope audits of all benefit plans under the Employee Retirement Income Security Act (ERISA); and 2) Require the auditor to undergo a peer review every three years. The AICPA supports the full-scope audit recommendation and is working with the DOL to ensure that IPA audit work is performed in a thorough manner consistent with the AICPA's professional standards regarding the responsibility to detect and report errors and irregularities. S. 2012, a bill to eliminate limited scope audits, was introduced on January 23, 1990. In March 1990, the DOL submitted a legislative proposal to Congress which would repeal limited scope audits and require an IPA to undergo a peer review every three years. **The DOL is preparing another legislative proposal which has not yet been sent to Congress. The AICPA testified on ERISA compliance before Congress most recently on June 13, 1990, and recommended that enforcement of present penalties be increased instead of imposing new penalties and that the Congress must provide the necessary funding to ensure adequate enforcement. The AICPA also emphasized that audits conducted in accordance with generally accepted auditing standards are not designed to assure compliance with all legislative and regulatory requirements and that if Congress wants the independent auditor to expand the scope of work beyond an audit of the financial statements of a covered plan, it must be explicit in what it requires**. For further details see page 7.

Improved Federal Financial Management

The federal government of the United States operates the largest financial organization in the world. Yet it does not provide complete, consistent, reliable, useful and timely information about its operations and financial conditions. The AICPA believes it is time for the Congress to enact legislation that will require more effective financial management systems and accountability. The AICPA has submitted a draft bill encompassing the recommendations of its Task Force on Improving Federal Financial Management to the House and Senate and is working with the chairmen and ranking minority members of the Senate Governmental Affairs and House Government Operations Committees. For further details see page 8.

Litigation Reform

Because accountants have become easy targets for plaintiffs when the accountants are the only survivors after the failure of a client company, and because accountants are often perceived as having "deep pockets," increasing numbers of lawsuits are being brought against them. The AICPA believes that it is essential that tort litigation reform legislation be enacted to reduce accountants' legal liability. For further details see page 9.

Telemarketing Fraud Legislation

Legislation has been introduced in the House and Senate designed to curb telemarketing fraud and other abuses. In the House, the measure has been approved by the Energy and Commerce Committee and reported to the House for consideration. **In the Senate, the Commerce Consumer Subcommittee held a hearing on May 2, 1990 on the two telemarketing bills which have been introduced in the Senate**. The importance of the telemarketing legislation from the point of view of the accountancy profession is to ensure that the terms are defined precisely enough so that legitimate businesses using the telephone in routine business transactions will not be covered. Imprecise language could result in the federalization of all common law fraud claims in commercial litigation. For further details see page 10.

Legislation to Create SRO for Investment Advisers

Proposed legislation drafted by the SEC to create one or more self-regulatory organizations (SROs) for investment advisers by amending the Investment Advisers Act of 1940 has been introduced in the House and Senate. The SROs would establish qualification and business practice standards, perform inspections, and enforce compliance with the law, under SEC oversight. The AICPA has written to the sponsors of the Senate bill outlining the concerns the profession has about the measure. **The House Energy and Commerce Subcommittee on Telecommunications and Finance has announced a July 18, 1990 hearing on the legislation and has invited the AICPA to testify**. For further details see page 11.

Investment Advisers Disclosure and Enforcement Act of 1990

H.R. 4441, the Investment Advisers Disclosure and Enforcement Act of 1990, introduced by Rep. Rick Boucher (D-VA) is aimed at protecting investors from fraud and abuse by financial planners. The bill would expand the definition of "investment adviser" under the Investment Advisers Act of 1940 to include those using the term "financial planner" or similar terms and narrow the current exclusion available to accountants under the 1940 Act. Financial planners would be required to register with the SEC under the 1940 Act and disclose such information as their qualifications and sources of income, including investment commissions and brokerage fees. A private right of action, permitting clients to sue the adviser, is also created by H.R. 4441, and the fraud provisions of the 1940 Act are expanded by adding new fines and criminal penalties for violations. The AICPA opposes H.R. 4441 as it is currently written, and is working with Rep. Boucher to reduce the liability of CPAs offering investment and financial planning advice. **The House Energy and Commerce Subcommittee on Telecommunications and Finance has announced a July 18, 1990 hearing on H.R. 4441 and has invited the AICPA to testify**. For further details see page 12.

New SEC Enforcement Powers

The final report of the National Commission on Fraudulent Financial Reporting, more commonly known as the Treadway Commission, included recommendations to expand the SEC's enforcement authority. **Legislation has been approved by the Senate Banking Committee and the House Energy and Commerce Subcommittee on Telecommunications and Finance** which would authorize the SEC to 1) issue permanent and in some circumstances temporary cease and desist orders; 2) affirm the authority of the courts to bar persons from serving as officers and directors of public companies; and 3) authorize the SEC to seek monetary penalties in civil actions and to impose monetary penalties in administrative proceedings in certain defined circumstances. The penalty provisions of the measure do not appear to apply to Rule 2(e) proceedings involving attest functions, although cease and desist powers may be employed to compel an accounting and disgorgement. **H.R. 975 is expected to be scheduled for mark-up in the full committee in the near future**. While the legislation is of interest to the accounting profession, it is consistent with the overall objective of the Treadway Commission. The AICPA has not taken a position on the legislation. For further details see page 13.

Shift in Workload for CPAs Caused by TRA '86

The Tax Reform Act of 1986 (TRA '86) greatly increased the complexity of the Internal Revenue Code and required trusts, partnerships, S corporations, and personal service corporations to adopt a calendar year end for tax purposes. Partnerships, S corporations and personal service corporations were subsequently allowed to retain their fiscal year ends. However, trusts were required to switch to a calendar year and many other entities also switched to a calendar year. As a result of the increased complexity in the tax code and the shift in year ends, accounting firms are now experiencing a workload that is unacceptably heavy from December through May and unacceptably light for the remainder of the year. The imbalance applies to accounting and auditing clients, as well as tax clients. The AICPA testified at a House Ways and Means Committee hearing on February 7, 1990 that the workload compression caused by the change in fiscal year ends is one of the main problems created by TRA '86. The AICPA is working with the Ways and Means and Senate Finance Committees to determine the most effective legislative strategy to resolve the problem. **A legislative proposal to liberalize section 444 has been developed by the AICPA and is being presented to Members of Congress**. For further details see page 14.

Estate Freezes

Section 2036(c) of the Internal Revenue Code precludes a freeze on the value of an owner's interest in a family-owned business at the time the business is passed on to the next generation. Taxpayers and tax practitioners have had difficulty in interpreting section 2036(c). **At an April 24, 1990 hearing on a discussion draft of a bill to modify section 2036(c) released by House Ways and Means Committee Chairman Dan Rostenkowski (D-IL), the AICPA testified in support of repealing section 2036(c). The AICPA also called for roundtable discussions on estate freezes**. The Senate Finance Committee has held one day of hearings on the issue, **and two Finance subcommittees have announced a joint hearing on June 27, 1990 to discuss changes to section 2036(c)**. For further details see page 15.

Additional Tax Issues

Other tax issues on which the AICPA is working are tax simplification and inventory capitalization. The AICPA has submitted a comprehensive package of tax simplification recommendations to the House Ways and Means Committee and presented testimony before the Committee on the impact of tax law complexity on taxpayer noncompliance. The AICPA also delivered over 10,000 letters from accountants nationwide calling for an end to "crazy" tax law. With respect to inventory capitalization, the AICPA recommends that the small businesses which must deal with the uniform capitalization of inventory be permitted to elect to use a percentage table which would approximate the complex calculations contained in current law. An AICPA Inventory Simplification Task Force survey found that the cost of complying with such detailed calculations often exceeds the tax resulting from the inventory rules. The survey results are being used to formulate specific simplification recommendations to present to the Treasury Department. For further details see page 16.

RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS ACT (RICO)

ISSUE: Should the civil provisions of RICO be amended to protect routine business activities which are not connected to "organized crime," "racketeers," or the "mob" from such allegations and litigation?

WHY IT'S IMPORTANT TO CPAs: The Racketeer Influenced and Corrupt Organizations (RICO) Act is the part of the 1970 Organized Crime Control Act which authorizes private parties injured by a "pattern" of "racketeering activity" to sue for treble damages and attorneys' fees. Despite the fact that Congress intended the statute to be used as a tool to fight organized crime, RICO is commonly used in commercial litigation since the law includes mail fraud, wire fraud, and securities fraud in its description of racketeering activities. Increasingly, accountants and other respected businessmen are included as co-defendants in these cases. The U.S. Supreme Court has twice refused to narrow the scope of the civil provisions of RICO, ruling that it is the Congress, not the courts that must correct the abuse of the RICO statute. However, efforts to amend RICO's civil provisions were unsuccessful in the 99th and 100th Congresses.

RECENT ACTION: In the 101st Congress, RICO reform legislation has again been introduced. Rep. Rick Boucher (D-VA) has introduced H.R. 1046 and Sen. Dennis DeConcini (D-AZ) has introduced S. 438.

The Senate Judiciary Committee approved S. 438 on February 1 by a vote of 11-2, but a vote by the full Senate has not yet been scheduled. S. 438, as approved by the Judiciary Committee, would permit recovery on only single damages in most RICO cases, including federal securities and commodities law cases, and cases where one business sues another business. S. 438 would also apply only to future RICO cases.

In the House, three hearings on H.R. 1046 have been held by the House Judiciary Crime Subcommittee. The most recent hearing was held on July 20, 1989. <u>**A new RICO reform proposal was introduced on June 21, 1990, by Rep. William J. Hughes (D-NJ), the chairman of the House Crime Subcommittee and Reps. Boucher and Bill McCollum (R-FL). The new bill, H.R. 5111, takes a different approach than S. 438 or H.R. 1046. H.R. 5111 gives wide discretionary latitude to the judge to review civil RICO claims at any time prior to final judgement. The new bill clarifies the Congressional intent that civil RICO is an "extraordinary remedy" aimed at "egregious conduct**</u>."

AICPA POSITION: The AICPA supports Congressional efforts to redirect the RICO statute to its intended purpose of attacking organized crime. The AICPA supports the House and Senate legislation and has been involved in efforts to amend civil RICO since the 99th Congress.

JURISDICTION: House Judiciary. Senate Judiciary.

AICPA STAFF CONTACTS: B. Z. Lee - Deputy Chairman, Federal Affairs
J. T. Higginbotham - Vice President, Legislative Affairs

<u>CONGRESSIONAL OVERSIGHT OF THE SEC'S ENFORCEMENT AND THE ACCOUNTING PROFESSION'S PERFORMANCE UNDER THE SECURITIES LAWS</u>

ISSUE: Are independent auditors fulfilling their responsibilities relative to audits of publicly owned corporations?

WHY IT'S IMPORTANT TO CPAs: Hearings on the accounting profession focusing on the effectiveness of independent accountants who audit publicly owned corporations and the performance of the SEC in meeting its responsibilities began in February 1985. Rep. John Dingell (D-MI), the chairman of the Subcommittee on Oversight and Investigations of the House Energy and Commerce Committee, conducted the hearings.

To date, 23 oversight hearings have been held and 153 witnesses have testified. Representatives of the AICPA have testified on three occasions. No hearings have been held in the Senate.

RECENT ACTION: No hearings have been held in the 101st Congress. <u>However, Rep. Ron Wyden (D-OR) has circulated for comment a draft bill which would require auditors to 1) report on internal controls and 2) report on evidence of material financial fraud or potential financial failure to regulators. The draft bill has not been introduced in the House and is a revised version of two bills Rep. Wyden introduced in 1986. The measure would apply to those audits performed under the federal securities laws</u>.

AICPA POSITION: Independent auditors are fulfilling their responsibilities concerning audits of publicly owned corporations. <u>The AICPA has opposed similar legislation offered by Rep. Wyden in previous Congresses</u>. The profession has an on-going effort aimed at improving audits performed by CPAs and addressing changes and developments in the market place. It has recently taken a number of steps to enhance the effectiveness of independent audits. These include:

- Requiring all members that audit publicly-held companies to belong to the SEC Practice Section which includes a peer review every three years conducted under the supervision of the Public Oversight Board.
- Revising auditing standards on internal control, fraud and illegal acts, auditors' communications and other "expectation gap issues."
- Creating the National Commission on Fraudulent Financial Reporting, chaired by former SEC Commissioner James C. Treadway, and working to implement the recommendations.
- Adopting a new requirement of members of the SEC Practice Section to notify the SEC when the firm is no longer the auditor of the company.
- Requiring all members, including those not in public practice, to complete a specified number of continuing professional education credits.

JURISDICTION: House Energy and Commerce. Senate Banking, Housing and Urban Affairs.

AICPA STAFF CONTACTS: B. Z. Lee - Deputy Chairman, Federal Affairs
J. F. Moraglio - Vice President, Federal Government Division

DOL OIG REPORTS ON PENSION PLAN SECURITY AND ERISA AUDITS

ISSUE: The adequacy of the current scope of audits of pension plans.

WHY IT'S IMPORTANT TO CPAs: The Employee Retirement Income Security Act (ERISA) is designed to provide safety and security for retirement plan funds. The Department of Labor (DOL) is responsible for overseeing the private pension plans system guaranteed by the U.S. government.

The DOL's Office of Inspector General (OIG) has issued three reports concerning independent audits of private pension plans. The first report, issued in December 1987, was based on a review of information of selected ERISA plans and identified some audit and reporting deficiencies. The second report, the Inspector General's Semiannual Report to Congress for the period ending March 31, 1989, advocated stricter standards and expanded responsibilities for independent qualified public accountants (IPAs) and questioned the adequacy of audit reports by IPAs on private pension plans. The report also questioned the DOL's oversight of pension plan assets and said that an unknown portion of those assets may be at risk. The third DOL OIG report, released in November 1989, found some of the audits reviewed did not comply with one or more auditing standards.

RECENT ACTION: On June 12-13, 1990, the House Ways and Means Oversight Subcommittee held hearings focusing on the enforcement and administration of ERISA. On March 6, 1990, the Senate Labor Subcommittee also held a hearing on ERISA enforcement. In 1989, three hearings were held by House subcommittees of the Government Operations and Aging Committees, and one hearing by an ERISA Enforcement Work Group. These hearings also focused on ERISA enforcement. S. 2012, which would eliminate limited scope audits of pension plans under ERISA, was introduced on January 23, 1990 by Senators Nancy Kassebaum (R-KS) and Orrin G. Hatch (R-UT). In March 1990, the DOL submitted a legislative proposal to Congress which would repeal the limited scope audit exemption, and require that an IPA obtain a peer review every three years. The DOL is developing another legislative proposal that has not yet been sent to Congress.

AICPA POSITION: The AICPA has been working with DOL representatives since the 1987 report was released in order to address the matters discussed in the report. The AICPA supports the DOL OIG's recommendation that all pension plan audits be of full scope and is working with the DOL to revise the Institute's Audit and Accounting Guide, Audits of Employee Benefit Plans.

The AICPA testified at the June 13, 1990 Ways and Means Oversight Subcommittee hearing, at two of the 1989 Congressional hearings and at the ERISA Enforcement Work Group hearing. The June 1990 AICPA testimony recommended that instead of imposing new penalties, enforcement of present penalties be intensified, and the Congress provide adequate funding to vigorously enforce present rules. The AICPA emphasized that audits conducted in accordance with generally accepted auditing standards are not designed to assure compliance with all legislative and regulatory requirements. If the Congress wishes the auditor to expand the scope of work beyond an audit of the financial statements of a covered plan and include a report on compliance with certain laws and regulations, the AICPA said it would work with DOL to accomplish that goal, but the DOL and Congress must be explicit in what is to be required. The AICPA also called for roundtable discussions between all involved parties to help ensure adequate ERISA enforcement.

JURISDICTION: House Government Operations. Senate Governmental Affairs.

AICPA STAFF CONTACTS: J. F. Moraglio - Vice President, Federal Government Division
I. A. MacKay - Director, Federal Government Division

IMPROVED FEDERAL FINANCIAL MANAGEMENT

ISSUE: Adoption of meaningful financial practices by the U.S. government.

WHY IT'S IMPORTANT TO CPAs: Although the government of the United States is the world's largest financial operation, its financial management concepts and practices are weak, outdated and inefficient. In December 1989, the Office of Management and Budget (OMB) issued a list of government programs vulnerable to fraud, waste, and abuse, which identified trouble spots in 16 federal departments and agencies.

RECENT ACTION: The AICPA has sent a draft bill encompassing the recommendations of its Task Force on Improving Federal Financial Management (recommendations are detailed below) to the House and Senate, and is working with the chairmen and ranking minority members of the Senate Governmental Affairs Committee and the House Government Operations Committee, in order to have meaningful legislation enacted.

Hearings which had been scheduled by the Senate Governmental Affairs Committee for the end of March were cancelled, primarily because of unresolved differences within the Administration and because of differing views between the Administration and the General Accounting Office. Discussions are continuing.

AICPA POSITION: The AICPA is concerned about the federal government's lack of effective financial management systems and accountability and it urges the legislative and executive branches to work together to improve this situation. In December 1989, the Institute held a national colloquium on improving federal financial management.

The AICPA Task Force on Improving Federal Financial Management has developed recommendations to assist the Congress and the Administration in improving federal financial management. These recommendations were issued in September 1989 in a discussion memorandum and include:

- Establishing the office of chief financial officer for the federal government and controllers for each executive department and agency who would implement a requirement for government-wide financial accounting and reporting, including related systems.

- Establishing a uniform body of accounting and financial reporting standards for the federal government to be used by all departments and agencies.

- Mandating the issuance of annual financial statements at the department and agency level, and government-wide prepared in accordance with established standards in a complete, consistent, reliable, and timely manner.

- Mandating a program of independent audits to provide annually to the President, the Congress, and the American people an independent opinion on the financial statements of the federal government and its agencies.

JURISDICTION: House Government Operations. Senate Governmental Affairs.

AICPA STAFF CONTACTS: J. F. Moraglio - Vice President, Federal Government Division
J. T. Higginbotham - Vice President, Legislative Affairs

LITIGATION REFORM

ISSUE: Should Congress enact legislation which would reform the present parameters of tort litigation?

WHY IT'S IMPORTANT TO CPAs: In our litigious society, accountants have become easy targets for plaintiffs when the accountants are the only survivors after the failure of a client company. The Accountants' Legal Liability Subcommittee of the AICPA Government Affairs Committee has been charged with the responsibility of identifying ways to reduce our liability exposure. For the last two years, the Subcommittee has directed much of its attention to the various tort reform efforts within the states. On the federal level, it has focused on the civil RICO reform effort.

RECENT ACTION: S. 1100, the Lawsuit Reform Act of 1989, was introduced by Senator Mitch McConnell (R-KY) on June 1, 1989. S. 1100 would abolish joint and several liability in civil actions in federal and state courts based on any cause of action, including economic losses.

AICPA POSITION: The AICPA strongly supports S. 1100 and worked with Senator McConnell's staff in developing S. 1100. The AICPA believes the chief cause of the liability crisis is a tort system which has become dangerously out of balance as the result of a trend of expanding liability. We recognize that legitimate grievances require adequate redress, but fairness demands equity for the defendant as well as the plaintiff. Such equity is now lacking in the system, and the balance must be restored.

The AICPA has identified five principal areas in need of legislative reform:

- Proportionate Liability. The most significant area in need of reform is the replacement of the prevailing rule of "joint and several" liability with "several" liability alone, in federal and state actions predicated on negligence, which would protect a defendant from paying more than his proportionate share of the claimant's loss relative to other responsible persons.

- Suits by Third Parties - The Privity Rule. The second target area for reform is the promotion of adherence to the privity rule as a means of countering the growing tendency to extend accountants' exposure to liability for negligence to an unlimited number of unknown third parties with whom the accountant has no contractual or other relationship.

- Racketeer Influenced and Corrupt Organizations Act (RICO). Please see the RICO issue section of the Digest (page 5).

- Costs and Frivolous Suits. Another prime concern is deterrence of the increasing numbers of frivolous suits and attorneys' fees arrangements that provide incentives for the plaintiffs' bar to file lawsuits against "deep pocket" defendants regardless of merit.

- Aiding and Abetting Liability. The AICPA also believes there is a need to clarify the scienter or knowledge standard by which auditors may be held secondarily liable for aiding and abetting a violation of law by those who are primarily responsible. Specifically, the AICPA supports legislative reforms to require a finding of actual knowledge by the CPA of the primary party's wrongdoing.

JURISDICTION: House Judiciary. Senate Judiciary.

AICPA STAFF CONTACT: P. V. Geoghan - Assistant General Counsel

TELEMARKETING FRAUD LEGISLATION

ISSUE: Whether Congress, in seeking to combat "telemarketing fraud," should carefully craft legislation to ensure that any private cause of action does not become a vehicle for federalizing all common law fraud claims in commercial litigation.

WHY IT'S IMPORTANT TO CPAs: The Telemarketing Fraud Prevention Act of 1989, introduced in the House by Rep. Tom Luken (D-OH), included such a broad definition of "telemarketing" when it was introduced that CPAs and other legitimate businesses could have been covered. The bill, H.R. 1354, directs the Federal Trade Commission (FTC) to issue rules governing telemarketing activities. It also included a provision permitting individuals meeting a $50,000 threshold to bring suits against entities engaging in telemarketing fraud or dishonest acts or practices. <u>In the Senate, S. 2494, the Telemarketing Fraud and Abuse Prevention Act of 1990, was introduced on April 23, 1990 by Senator Richard Bryan (D-NV). The definition of "telemarketing" in S. 2494 would encompass the activities of CPAs who use the telephone in the course of engaging in routine business transactions, including the solicitation of business. S. 2494 also includes a $50,000 threshold for bringing civil suits</u>.

RECENT ACTION: The Subcommittee on Transportation and Hazardous Materials of the House Committee on Energy and Commerce during markup amended the definition of "telemarketing" for all purposes under H.R. 1354. As amended, "telemarketing" would not include any sales transaction where there was a face-to-face meeting, prior to the consummation of the sale, between the seller of services or his agent and the purchaser or his agent, even if the telephone was otherwise used to initiate, pursue, or consummate the sales transactions. Therefore, as long as each specific individual sale or service transaction of CPAs includes at least one meeting in person with representatives of the potential client, such specific services would not subsequently be considered sold through telemarketing.

The full Energy and Commerce Committee approved H.R. 1354 on October 24, 1989 and reported it to the full House for consideration. The reported bill includes the $50,000 threshold and the "telemarketing" definition approved by the subcommittee. These provisions should minimize use of the proposed statute against legitimate businesses. The full committee also approved an amendment exempting the securities industry from coverage, as well as investment advice related to securities which is offered by any investment adviser, as defined by the Investment Advisers Act of 1940 or the Investment Company Act of 1940.

<u>The Senate Commerce Consumer Subcommittee held a hearing May 2, 1990 on S. 2494 and S. 1441, which also seeks to enhance the authority of the FTC to prevent telemarketing fraud. S. 1441 was introduced on July 31, 1989 by Senator John McCain (R-AZ)</u>.

AICPA POSITION: The AICPA supports efforts to ensure that the terms used in any federal telemarketing fraud legislation are not so broad that the statute could be construed to cover the activities of legitimate businesses that use the telephone in the course of engaging in routine business transactions. In early 1989, the AICPA noted its concern about the broad application of H.R. 1354, as it was originally drafted, in a letter to Rep. Luken and urged that the measure be amended so that it effectively addressed true telemarketing fraud. <u>The AICPA is also working to amend S. 2494</u>.

JURISDICTION: House Energy and Commerce. Senate Commerce, Science and Transportation.

AICPA STAFF CONTACT: B. Z. Lee - Deputy Chairman, Federal Affairs

LEGISLATION TO CREATE SELF-REGULATORY ORGANIZATION (SRO) FOR INVESTMENT ADVISERS

ISSUE: Should Congress create a self-regulatory organization (SRO) for investment advisers.

WHY IT'S IMPORTANT TO CPAs: Individuals who fall within the definition of investment adviser under the Investment Advisers Act of 1940 are required to register with the SEC, unless they qualify for one of the Act's exceptions. The SEC is authorized to inspect their books and records, establish certain disclosure requirements, and bring civil actions for fraud and other securities law violations. However, because there is no SRO for investment advisers, the SEC must conduct direct examinations. The SEC's limited budget allows it to inspect investment advisers once every twelve years. While the SEC targets higher risk investment advisers for more frequent inspections and while periodic investigations are also conducted by state regulators, this has not proven to be adequate to prevent fraud and illegal activity. In addition, other individuals who operate as investment advisers are not required to register with the SEC, either because they fall within one of the exceptions of the 1940 Act or because they do not give financial advice about securities. In September 1988, the SEC proposed a rule which would exempt small-scale investment advisers from SEC registration requirements and shift those responsibilities to the states. The rule has not been adopted.

RECENT ACTION: In July 1989, draft legislation submitted by the SEC to the Congress was introduced in the House and Senate. The legislation authorizes the SEC to register one or more national investment adviser associations to provide a self-regulatory mechanism for investment advisers by amending the Investment Advisers Act of 1940. The SROs would establish qualification and business practice standards, perform inspections, and enforce compliance with the law, under SEC oversight. H.R. 3054 was introduced by Rep. John Dingell (D-MI), the chairman of the House Energy and Commerce Committee, and was co-sponsored by 12 other members of the committee. S. 1410 was introduced by Senators Christopher Dodd (D-CT) and John Heinz (R-PA), the chairman and ranking minority member, respectively, of the Senate Banking Subcommittee on Securities.

The Energy and Commerce Subcommittee on Telecommunications and Finance has announced a July 18, 1990 hearing on H.R. 3054 and H.R. 4441, the Investment Advisers Disclosure and Enforcement Act of 1990. (For details about H.R. 4441, see page 12). The AICPA has been invited to testify at the July 18 hearing. No hearings have been announced in the Senate.

AICPA POSITION: In October 1989, the AICPA wrote to Senators Dodd and Heinz in response to a request for comments on S. 1410. The AICPA said it does not have an "independent judgment whether a new statutorily ordained SRO is necessary or appropriate for the investment advisory community at large." What is of concern, is that inclusion of CPAs in such an SRO would result in "a duplicative and costly supervisory system without commensurate benefit to the investing public." The letter also urged that S. 1410 be modified to "restate, reinforce, and clarify" the intent of the 76th Congress when it adopted the exemption for accountants in the Investment Advisers Act of 1940. Further, the letter stated that any clarification of the Advisers Act should focus on how services are performed by CPAs, rather than on what they are called and how they are presented to the public. The letter also noted the growing move by states to regulate investment advisers and personal financial planners, and urged that if a federal scheme is adopted for such regulation it should supersede similar state laws and regulations.

JURISDICTION: House Energy and Commerce. Senate Banking, Housing and Urban Affairs.

AICPA STAFF CONTACTS: J. T. Higginbotham - Vice President, Legislative Affairs
J. F. Moraglio - Vice President, Federal Government Division

INVESTMENT ADVISERS DISCLOSURE AND ENFORCEMENT ACT OF 1990

ISSUE: In trying to impose stiff sanctions on those "financial planners" who operate unethically and/or fraudulently, should the Investment Advisers Act of 1940 be amended to limit the accountant's exemption, require all who hold themselves out as financial planners to register as investment advisers, create a private right of action which would expand liability, and increase administrative sanctions and penalties for the entire financial planner/investment adviser community.

WHY IT'S IMPORTANT TO CPAs: H.R. 4441, introduced by Rep. Rick Boucher (D-VA), 1) expands the definition of "investment adviser" under the Investment Advisers Act of 1940 to include those using the term "financial planner" or similar terms; 2) narrows the current exclusion available to accountants under the Advisers Act; and 3) creates a private right of action under the Advisers Act permitting clients to sue the adviser.

The bill would also require financial planners to register with the SEC under the 1940 Act and disclose such information as their qualifications and sources of income, including investment commissions and brokerage fees. The bill also expands the fraud provisions of the 1940 Act adding new fines and criminal penalties for violations.

RECENT ACTION: H.R. 4441 was introduced April 2, 1990 and referred to the House Energy and Commerce Committee. Joining Rep. Boucher as co-sponsors of H.R. 4441 were Rep. John Dingell (D-MI), the chairman of the Energy and Commerce Committee, and five other members of the Committee. They are Reps. Edward Markey (D-MA), Dennis Eckart (D-OH), Jim Cooper (D-TN), Jim Slattery (D-KS), and Ron Wyden (D-OR).

The House Energy and Commerce Subcommittee on Telecommunications and Finance has announced a July 18, 1990 hearing on H.R. 4441 and H.R. 3054, which would create a self-regulatory organization for investment advisers. **(For details about H.R. 3054 see page 11.)** **The AICPA has been invited to testify at the July 18 hearing.**

Legislation similar to H.R. 4441 has not been introduced in the Senate.

AICPA POSITION: The AICPA opposes H.R. 4441 as currently written. There is no demonstrated need to regulate CPA financial planners who do not give specific investment advice, sell investment products or take custody of client funds. Documented abuses are centered in the sale of investment products and by individuals who control client funds.

The AICPA is working with Rep. Boucher to amend the bill to reduce the liability exposure of accountants and other professionals offering investment and financial planning advice.

JURISDICTION: House Energy and Commerce. Senate Banking, Housing and Urban Affairs.

AICPA STAFF CONTACT: J. T. Higginbotham - Vice President, Legislative Affairs

NEW SEC ENFORCEMENT POWERS

ISSUE: Does the SEC need new enforcement powers?

WHY IT'S IMPORTANT TO CPAs: In its final report released in October 1987, the National Commission on Fraudulent Financial Reporting (the Treadway Commission) recommended expanding the SEC's enforcement authority to enable the agency to:

- bar or suspend officers and directors of publicly held corporations;
- seek civil money penalties in injunctive proceedings;
- issue cease and desist orders when it finds a securities law violation;
- mandate audit committees composed of independent directors for all publicly held corporations; and
- impose civil money penalties in administrative proceedings, including Rule 2(e).

RECENT ACTION: At the beginning of the 101st Congress, legislation drafted by the SEC in response to the Treadway Commission's recommendations was introduced amending the federal securities laws. One day of hearings was held in 1989 by Senate and House committees on the measures, S. 647 and H.R. 975.

S. 647 and H.R. 975 enhance the enforcement authority of the SEC by:

- authorizing the SEC to issue permanent cease and desist orders, after notice and opportunity for hearing, and in some circumstances, temporary cease and desist orders, without a hearing;
- affirming the authority of the courts to bar persons from serving as officers and directors of issuers who are subject to the registration and reporting requirements of the securities laws; and
- authorizing the SEC to seek monetary penalties in civil actions and to impose monetary penalties in administrative proceedings in certain defined circumstances.

The penalty provisions of S. 647 and H.R. 975 are not, on their face, available in Rule 2(e) proceedings involving attest functions, although cease and desist powers may be employed to compel an accounting and disgorgement. The legislation does not address mandated audit committees.

<u>In the Senate, S. 647 was ordered reported from the Banking, Housing and Urban Affairs Committee on May 24, 1990. In the House, H.R. 975 was reported from the House Energy and Commerce Subcommittee on Telecommunications and Finance on June 20, 1990. A full committee mark-up is expected to be scheduled in the near future</u>.

AICPA POSITION: While the legislation is of interest to the accounting profession, it is consistent with the overall objective of the Treadway Commission. The AICPA has not taken a position on the legislation.

JURISDICTION: House Energy and Commerce. Senate Banking, Housing and Urban Affairs.

AICPA STAFF CONTACTS: J. T. Higginbotham - Vice President, Legislative Affairs
J. F. Moraglio - Vice President, Federal Government Division

SHIFT IN WORKLOAD FOR CPAs CAUSED BY TRA '86

ISSUE: Taxpayers and their tax advisers are experiencing significant workload shifts as a result of the Tax Reform Act of 1986 (TRA '86) and the switch from fiscal years to calendar years.

WHY IT'S IMPORTANT TO CPAs: TRA '86 greatly increased the complexity of the Internal Revenue Code and required trusts, partnerships, S corporations and personal service corporations to adopt a calendar year-end for tax purposes. Ultimately, as a result of an all-out effort by thousands of CPAs throughout the nation, TRA '86 was modified by section 444 of the Revenue Act of 1987 to permit retention or adoption of fiscal years for partnerships, S corporations, and personal service corporations. Trusts, however, were required to adopt a calendar year, and many other entities also switched to a calendar year. The change to the calendar year by so many firms' clients, coupled with the fact that firms now must spend more time with each client because of the increased complexity of the law, has resulted in a workload that is unacceptably heavy from December through May and unacceptably light during the remainder of the year. The workload imbalance applies not only in the tax area, but also in the areas of accounting and auditing. Firms with accounting and auditing clients face an imbalance because financial statements and audit reports are typically due within 90 days after year end.

RECENT ACTION: The House Ways and Means Committee has held three days of hearings on the impact, effectiveness, and fairness of TRA '86. The hearings were held on February 7 and 8 and March 5, 1990. The AICPA testified at the February 7 hearing that the workload compression caused by the change in fiscal year ends was one of the main problems created by TRA '86.

AICPA POSITION: AICPA representatives are working with the Ways and Means and Senate Finance Committees to liberalize and simplify section 444. <u>The AICPA has developed a legislative proposal to liberalize section 444 which is being presented to Members of Congress</u>.

JURISDICTION: House Ways and Means. Senate Finance.

AICPA STAFF CONTACTS: D. H. Skadden - Vice President, Federal Taxation Division
C. B. Ferguson - Technical Manager, Federal Taxation Division

ESTATE FREEZES

ISSUE: Should Congress enact legislation to allow a "freeze" of estate values in order to facilitate the transfer of family-owned business from one generation to another.

WHY IT'S IMPORTANT TO CPAs: Taxpayers and tax practitioners have experienced significant difficulties in interpreting Internal Revenue Code section 2036(c), concerning estate freezes, enacted by the Congress in 1987. The confusion was compounded by the fact that the IRS did not issue interpretive guidance until September 1989 when Notice 89-99 was released.

An estate freeze is an estate planning technique by which family businesses are transferred to the next generation. The effect of an estate freeze is to freeze the value of one generation's interest in a family-owned business. In a typical estate freeze, the business would be recapitalized by the owner taking most of the current value of the business in the form of preferred stock and children or grandchildren being given common stock. Gift taxes are paid on the value of the stock given to the children or grandchildren at the time of the recapitalization. The IRS encountered abuses by certain owners concerning undervaluation of assets in order to escape the transfer tax system. Section 2036(c) was enacted in an effort to correct the valuation problems. It precludes a freeze of the value of the owner's interest at the time the business is passed on to the next generation, and before the business appreciates under their management. However, without an estate freeze, the entire value of a family business could be included in the owner's estate.

RECENT ACTION: Several bills have been introduced in the Senate to repeal section 2036(c). The measures are S. 659, introduced by Sen. Steve Symms (R-ID); S. 849, introduced by Sen. Tom Daschle (D-SD); S. 838, introduced by Sen. Howell Heflin (D-AL); and S. 1688, introduced by Sen. Max Baucus (D-MT). A hearing on the legislation was held on May 17, 1989 by the Senate Finance Committee. In the House of Representatives, H.R. 60 was introduced by Rep. Bill Archer (R-TX) to repeal section 2036(c). H.R. 60, which has 229 co-sponsors, was referred to the House Ways and Means Committee. No hearings have been held on H.R. 60.

On March 22, 1990, Rep. Dan Rostenkowski (D-IL), the chairman of the House Ways and Means Committee, released a discussion draft of a bill to modify section 2036(c). The Ways and Means Committee held a hearing on the discussion draft on April 24, 1990.

<u>In the Senate, two Finance subcommittees--the Subcommittee on Taxation and Debt Management and the Subcommittee on Energy and Agricultural Taxation--have announced a joint hearing on June 27, 1990 to discuss changes to section 2036(c)</u>.

AICPA POSITION: <u>The AICPA testified in support of repealing section 2036(c) effective retroactively to December 17, 1987 at the April 24, 1990 Ways and Means hearing. At that hearing, the AICPA asked Rep. Rostenkowski to hold roundtable discussions on estate freezes with various organizations, the IRS, Department of Treasury and staff of the Ways and Means Committee</u>. The AICPA also testified in support of repeal at a September 13, 1989 hearing before the Senate Small Business Committee at a hearing focusing on small business taxation issues.

JURISDICTION: House Ways and Means. Senate Finance.

AICPA STAFF CONTACTS: D. H. Skadden - Vice President, Federal Taxation Division
L. M. Bonner, Technical Manager, Federal Taxation Division

ADDITIONAL TAX ISSUES

o TAX SIMPLIFICATION:

The Tax Division's Tax Simplification Committee continues to actively promote an enhanced awareness of the need to consider simplification and efficiency in future tax legislative and regulatory activity; to identify specific areas in existing tax law in need of simplification; and, to work with Congress and the Treasury on the implementation of simplification proposals.

Recent projects include: Submission of a comprehensive package of tax simplification recommendations to the House Ways and Means Committee in response to Committee Chairman Dan Rostenkowski's (D-IL) "major tax simplification study;" congressional testimony on the impact of tax law complexity on taxpayer noncompliance; and delivery of over 10,000 letters from accountants nationwide addressed to Rep. Rostenkowski calling for an end to "crazy" tax law.

In addition, the AICPA Tax Division sponsored, in conjunction with the American Bar Association Section of Taxation, the January 1990 Invitational Conference on Reduction of Income Tax Complexity. Leading tax practitioners and policymakers presented and discussed detailed tax policy papers on tax complexity. These papers provided in-depth analyses of the factors that cause tax law complexity and offered some provocative new proposals for responding to the problems.

The Committee is actively seeking additional ideas and input. Individuals should send any ideas for simplifying the tax law to: Tax Simplification Ideas, AICPA, 1455 Pennsylvania Ave., N.W., Washington, D.C. 20004. AICPA staff contacts are D. H. Skadden and C. B. Ferguson.

o INVENTORY CAPITALIZATION (UNICAP):

The AICPA recommends that the small businesses which must deal with the uniform capitalization of inventory be permitted to elect to use a percentage table which would approximate the complex calculations contained in current law. Another suggestion is to permit taxpayers who have complied with UNICAP rules to make an election to continue to use the capitalization rate they have developed. In many cases the cost to comply with the detailed calculations often exceeds the tax resulting from the new inventory rules.

This conclusion has been confirmed by the UNICAP survey prepared by the AICPA Inventory Simplification Task Force. The survey was conducted to accumulate data on the cost of compliance with these new rules. Currently, an AICPA Simplification Task Force is using the survey results to formulate specific simplification recommendations to present to the Department of the Treasury. AICPA staff contacts are D. H. Skadden and L. A. Winton.

OTHER ISSUES

Some of the other legislative, regulatory, and tax issues that the AICPA is monitoring include:

- Cash versus accrual method of accounting for tax purposes
- Pending SEC releases to require all independent accountants to undergo periodic peer review and management's reports on internal control
- Comprehensive review by the SEC Chief Accountant's Office of the SEC's independence rules applicable to accountants
- Quality of audits of federal financial assistance
- European Community Common Market Trade Agreement EURO (1992)
- Financial problems in the insurance industry
- Reform of civil justice procedures in federal courts under provisions of the Civil Justice Reform Act
- **Civil Rights Act of 1990**
- GAAP/RAP issues
- Mark to market - GAAP issues
- **Real estate appraisal legislation and regulation**
- Consultant registration and certification
- Capital gains tax proposals
- Legislation to establish a tax preparer's privilege
- Tax options for revenue enhancement
- Passive activity loss rules
- Unrelated Business Income Tax (UBIT)

If you would like additional details on any of these issues, please contact our office.

AICPA PROFILE

HISTORY

The American Institute of Certified Public Accountants (AICPA) was founded in 1887. Its creation marked the emergence of accountancy as a profession, distinguished by its educational requirements, high professional standards, strict code of professional ethics, licensing status, and commitment to serving the public interest.

The AICPA is the national professional association of certified public accountants in the United States. Members are CPAs from every state and territory of the United States, and the District of Columbia. Currently, there are approximately 300,000 members. Approximately 46 percent of those members are in public practice, and the other 54 percent include members working in industry, education, government, and other various categories.

OBJECTIVES

In its continuing effort to serve the public interest, the Institute creates and grades the Uniform CPA Examination, develops auditing standards, upholds the Code of Professional Ethics, provides continuing professional education and contributes technical advice to government and to private sector rule-making bodies in areas such as accounting standards, taxation, banking and thrifts.

LEADERSHIP

The Chairman of the AICPA Board of Directors is elected from the membership and serves a one-year term. The AICPA chairman for 1989-1990 is Charles Kaiser, Jr. of Los Angeles, CA. The chairman-elect is Thomas W. Rimerman of Menlo Park, CA.

Philip B. Chenok, CPA, is the President and Chief Executive Officer of the AICPA. Bernard Z. Lee, CPA, is Deputy Chairman - Federal Affairs.

The AICPA Council is the association's policy-making governing body. Its 260 members represent every state and U.S. territory. The Council meets twice a year.

The Board of Directors acts as the executive committee of Council, directing Institute activities between Council meetings. The 21 member Board of Directors includes 3 public members, all of whom are lawyers and 2 of whom are former SEC officials. The Board meets five times a year.

The AICPA has a permanent staff of nearly 700 and a budget of $104 million. The work of the AICPA is done primarily by its volunteer members serving on approximately 130 boards, committees, and subcommittees.